No. 77-1354

In the Supreme Court of the United States

OCTOBER TERM, 1977

RALPH FURRER and ROSEMARIE FURRER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1354

RALPH FURRER and ROSEMARIE FURRER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The question presented in this federal income tax case is whether the recovery petitioner[1] obtained in a state court action for breach of a special insurance agency agreement was taxable to him as ordinary income.

1. The pertinent facts are as follows: In 1959, petitioner entered into a special agency agreement with Industrial Hospital Association (IHA), pursuant to which he was to develop individual health insurance policies, and to recruit agents to sell the policies. Under the agreement, IHA granted petitioner the exclusive right to recruit agents to sell individual health insurance policies in every

---

[1]"Petitioner" refers to Ralph Furrer. Rosemarie Furrer is a party only because she joined with her husband in filing a joint return.

area in which it was licensed to do business. Petitioner, who undertook to bear most of the expenses incurred in his work, was to be compensated for his efforts solely on a commission basis (Pet. App. B, pp. 3b-4b).

The special agency agreement had a term of one year, with automatic yearly renewals, subject to a restricted right of termination exercisable by either of the parties. The agreement further provided that IHA could not terminate the special agency arrangement in any year in which premiums exceeded a certain amount and the ratio of claims to premiums was below a certain percentage (Pet. App. B, pp. 3b-5b).

In 1966, in contravention of the non-termination provisions of the agency contract, IHA cancelled petitioner's special agency. At that time, IHA took possession of the files petitioner maintained on sales agents he recruited. Petitioner thereafter brought suit against IHA in a state court, seeking damages for IHA's breach of the agency contract. In his complaint, petitioner alleged that he had been injured by IHA's failure to pay over earned commissions and by his loss of commission income (Pet. App. B, pp. 7b-8b).

At trial, the only evidence petitioner presented on damages pertained to his loss of commission income. The state court entered judgment awarding petitioner $213,001.48 plus interest. In computing these damages, the court first calculated the present value of commissions petitioner would have earned had the contract not been wrongfully terminated. It then reduced that amount by (1) certain payments IHA had previously made to petitioner, (2) the present value of the costs petitioner would have incurred performing the contract, and (3) the present value of petitioner's post-termination earning capacity. In 1970, the Oregon Supreme Court affirmed the judgment (Pet. App. B, p. 8b).

On his 1970 federal income tax return, petitioner reported his receipt of the damage recovery as capital gains. On audit, the Commissioner determined that petitioner's recovery was taxable as ordinary income and accordingly determined a deficiency. Both the Tax Court and the court of appeals upheld the Commissioner's determination, concluding that the recovery compensated for petitioner's loss of commission income and was taxable on the same basis as commission income (Pet. App. A; Pet. App. B, pp. 11b-18b).

2. The decisions below correctly held that petitioner's recovery of damages was taxable as ordinary income. The tax character of income realized in damage suits turns on the nature of the plaintiff's claims. Thus, if a person seeks damages to recompense his loss of ordinary income items, any recovery he receives is taxable as ordinary income. *Hort* v. *Commissioner*, 313 U.S. 28; cf. *Commissioner* v. *Gillette Motor Co.*, 364 U.S. 130; *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260.

Here, petitioner sought and received damages solely for his loss of commission income. His complaint, the nature of his proof, and the trial court's damage computations uniformly support that conclusion. As the court of appeals properly observed (Pet. App. A, pp. 6a-7a), the overwhelming weight of decisional authority is that amounts received under such circumstances are taxable as ordinary income. See, *e.g.*, *Vaaler* v. *United States*, 454 F. 2d 1120 (C.A. 8); *Elliott* v. *United States*, 431 F. 2d 1149 (C.A. 10); *Maryland Coal and Coke Co.* v. *McGinnes*, 350 F. 2d 293 (C.A. 3); *United States* v. *Eidson*, 310 F. 2d 111 (C.A. 5); *Holt* v. *Commissioner*,

303 F. 2d 687 (C.A. 9); *General Artists Corp.* v. *Commissioner*, 205 F. 2d 360 (C.A. 2); *Flower* v. *Commissioner*, 61 T.C. 140.[2]

The authorities petitioner cites (Pet. 14-18) are not to the contrary. Unlike those cases,[3] which involved the transfers of property interests, the only interest petitioner had in the agency arrangement at the time of termination was a future income interest in commissions to be earned by the rendition of personal services. No matter what good will, records or other "property" interests might have been generated by petitioner's performance of the contract, those interests either had vested in IHA before the termination or remained with petitioner after termination. Accordingly, the termination of the agency contract in no way effected any transfer of a "property" interest that might justify characterization of the transaction as an "exchange" giving rise to capital gains. Cf. *Commissioner* v. *Gillette Motor Co., supra; Commissioner* v. *The Pittston Company*, 252 F. 2d 344 (C.A. 2), certiorari denied, 357 U.S. 919.

---

[2]In *Jones* v. *Corbyn*, 186 F. 2d 450, the Tenth Circuit originally adopted a contrary position. But, as the Fifth Circuit has noted (*Bisbee-Baldwin Corporation* v. *Tomlinson*, 320 F. 2d 929, 933), the Tenth Circuit "expressly disapproved and in effect overruled" *Jones* v. *Corbyn, supra*, in its *en banc* decision in *Wiseman* v. *Halliburton Oil Well Cementing Co.*, 301 F. 2d 654, 659. See *Elliott* v. *United States, supra*. See also Pet. App. B, p. 18b n. 6.

[3]*Commissioner* v. *Ferrer*, 304 F. 2d 125 (C.A. 2); *Commissioner* v. *McCue Bros. & Drummond*, 210 F. 2d 752 (C.A. 2); *Commissioner* v. *Goff*, 212 F. 2d 875 (C.A. 3), certiorari denied, 348 U.S. 829; *Bisbee-Baldwin Corporation* v. *Tomlinson, supra; United States* v. *Dresser Industries, Inc.*, 324 F. 2d 56 (C.A. 5).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

MAY 1978.

DOJ-1978-05